IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CT

MARK NEWBY, *et al.*, Individually and On Behalf Of All Others Similarly Situated,	§	
	§	
Plaintiffs,	§	
	§	CIVIL ACTION NO. H-01-3624
v.	§	(Consolidated)
	§	
ENRON CORP., *et al.*,	§	
	§	
Defendants.	§	

RESPONSE OF OFFICER DEFENDANTS TO PLAINTIFFS' MOTION TO STRIKE DEFENDANTS' JOINT DISCLOSURE BRIEF AND REPLY TO PLAINTIFFS' OBJECTIONS TO DEFENDANTS' ARGUMENT

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Introduction

Defendants Richard Buy, Mark A. Frevert, Kevin Hannon, Joseph M. Hirko, Stanley C. Horton, Steven J. Kean, Mark E. Koenig, Jeffrey McMahon, Cindy K. Olson, Kenneth D. Rice, Joseph W. Sutton, and Lawrence G. Whalley ("Officer Defendants") file this response to Plaintiffs' Motion to Strike Certain Defendants' Joint Disclosure Brief ("Motion") and reply to Plaintiffs' Objection to Defendants' Argument ("Objection").

To state what may seem obvious, Plaintiffs' Motion and Objection, while filed as a single document, raises two distinct issues. In the Motion, Plaintiffs seek to have the Court strike the Officer Defendants' Brief Relating to Enron's Disclosures ("Joint Disclosure Brief"). In support of the Motion, Plaintiffs argue that Defendants have improperly introduced extraneous materials into the record on the motions to dismiss and have argued the facts to Plaintiffs' detriment. As set forth below, the Officer Defendants counter that these arguments are within the ambit of what the Court can and should consider in deciding the motions to dismiss. The bulk of Plaintiffs' filing is devoted to the Objection, which is the Plaintiffs' counter-spin to certain disclosures the Officer Defendants brought to the Court's attention.[1]

I. PLAINTIFFS' MOTION AND OBJECTION FAIL TO ADDRESS THE CONSOLIDATED COMPLAINT'S PLEADING DEFICIENCIES.

As one would expect, Plaintiffs' Consolidated Complaint focuses on Enron's public disclosures and claims that these disclosures were inadequate, misleading, fraudulent or all three. Yet, despite the length of the Consolidated Complaint, Plaintiffs fail to provide the requisite particularized allegations implicating the Officer Defendants in Enron's allegedly fraudulent scheme.

[1] To distinguish the two parts of Plaintiffs' pleading, references to the first ten pages are denoted "Motion at ___." The remainder is cited as "Objection at ___." James V. Derrick also joins in this Motion and Objection.

Plaintiffs never allege that any specific Officer Defendant was responsible for any Enron disclosure or lack of disclosure, and Plaintiffs never claim that any Officer Defendant knew information that would have required additional disclosures by Enron. In short, the Plaintiffs fail to meet their burden imposed by the PSLRA in this circuit and others to provide the who, where, when, and how of the allegedly fraudulent activity.

Plaintiffs have failed to plead fraud with the required particularity against the Officer Defendants despite the extensive public information now available regarding the "fall" of Enron, the many investigations, heightened publicity and public presumption of guilt. For that reason, and the reasons set forth below, Plaintiffs' Motion should be denied and the Court should dismiss Plaintiffs' Consolidated Complaint for failure to state a claim against the Officer Defendants. At a minimum, the motions to dismiss and Plaintiffs' various responses demonstrate the necessity for Plaintiffs to replead their claims.

Normally, one would expect Enron to defend the securities fraud claims by filing a motion to dismiss denying Plaintiffs' claims and relying on what it disclosed. Because of Enron's bankruptcy, Enron made no such defense. In Enron's stead, the Officer Defendants filed the Joint Disclosure Brief in support of their motions to dismiss and emphasized the information Enron's public disclosures contained. In effect the Officer Defendants took on the burden and role that Enron typically would have exercised in order to put into context their lack of involvement in the alleged fraudulent activity.

II. THE JOINT DISCLOSURE BRIEF SHOULD BE CONSIDERED IN SUPPORT OF THE OFFICER DEFENDANTS' MOTIONS TO DISMISS.

Plaintiffs move to strike the entire 245 page Joint Disclosure Brief on the ground that the brief allegedly asserts a handful of impermissible factual allegations. From Defendants' perspective, Plaintiffs' motion is a feeble attempt to divert the Court from the substance of the Joint Disclosure Brief to which Plaintiffs have no response – a painstakingly detailed demonstration of Plaintiffs' failure to plead a case of securities fraud with particularity. In their Motion and various responses to the Defendants' motions to dismiss, Plaintiffs fail again to respond to Enron's public disclosures that contradict Plaintiffs' vague, unsupported allegations of non-disclosure.

Using an exaggerated, distressed tone, Plaintiffs charge the Officer Defendants with "compound[ing] their error by attaching non-public, unauthenticated documents," insinuating that these documents form the core of the Officer Defendants' arguments. Contrary to Plaintiffs' alarmist rhetoric, however, Plaintiffs seek to strike only three of 163 exhibits included in the Master Appendix and Master SEC Appendix filed with the Joint Disclosure Brief. Those three documents are the transcripts of two analysts' conferences, statements from which are quoted by Plaintiffs in the Consolidated Complaint, and a PowerPoint slide presentation presented at one of those two analysts' conferences that is also referenced in the Consolidated Complaint. The Officer Defendants' discussion of these particular exhibits was limited to a narrow part of the Joint Disclosure Brief regarding Enron Broadband Services ("EBS"). Joint Disclosure Brief at 141-48.

Traditionally, courts considering a Rule 12(b)(6) motion to dismiss afford limited consideration to the facts stated in the complaint and any documents either attached to the complaint or incorporated into it. *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 881 (S.D. Tex. 2001). The PSLRA enlarged the body of materials that a court could consider when deciding a motion to dismiss in a securities fraud case. In considering the motions to dismiss that invariably follow the filing of a federal securities fraud claim, the PSLRA requires the Court to consider "documents 'integral to and explicitly relied on' in the complaint," that the defendant appends to his motion to dismiss, as well as the full text of documents that are partially quoted or referred to in the complaint. *Id.* at 882, *quoting Phillips v. LCI Intern., Inc.,* 190 F.3d 609, 618 (4th Cir. 1999); *see also Harris v. IVAX Corp.,* 182 F.3d 799, 802 n.2 (11th Cir. 1999); *San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 808-09 (2d Cir. 1996).

The Court may also consider the contents of relevant public disclosure documents which are required by law to be filed with the Securities Exchange Commission (the "SEC") and are actually filed with the SEC. *Lovelace v. Software Spectrum Inc.,* 78 F.3d 1015, 1018 (5th Cir. 1996); *In re BMC,* 183 F. Supp. 2d at 881-82.[2] While these documents cannot be considered for proving the truth of their contents, they should be considered to establish the statements they contain. *Id.* As the Eleventh Circuit has stated:

> [A] plaintiff whose complaint alleges that such documents are legally deficient can hardly show prejudice resulting from the court's studying of the documents. Were courts to refrain from considering such documents, complaints that quoted only selected and misleading portions of such documents could not be dismissed under Rule 12(b)(6) even though they would be doomed to failure. Foreclosing resort to such documents might lead to complaints filed solely to extract nuisance settlements.

Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1277 (11th Cir. 1999). Finally, courts now routinely consider "not just documents named in Plaintiffs' complaint, but even documents that, if not named, are 'pertinent,' 'central' or 'integral' to [Plaintiffs'] claim.'" *In re BMC,* 183 F. Supp. 2d at 883, *quoting Bryant,* 187 F.3d at 1281.

Nowhere in the Joint Disclosure Brief do the Officer Defendants ask the Court to accept disputed facts as true. Instead, the Joint Disclosure Brief refers the Court to disclosures Enron made as a response to Plaintiffs' claim that such disclosures were not made. Similarly, the Joint

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[2] Plaintiffs do not object to the submission of the SEC filings contained in the Master SEC Appendix. Motion at 8, n.7.

Disclosure Brief references certain safe harbor and bespeaks caution statements. It is axiomatic that the Court must review public statements to determine if disclosures were made in response to claims of non-disclosure. The Court is allowed to look at publicly filed documents and documents that are referenced in or integral to the Consolidated Complaint to review the *fact* that certain disclosures were made or not. *Lovelace,* 78 F.3d at 1018; *In re BMC*, 183 F. Supp. 2d at 881-82. If the Court finds that relevant disclosures were made, the Court can disregard Plaintiffs' contrary allegations, and dismiss the Consolidated Complaint under Rule 12(b)(6). *Lovelace*, 78 F.3d at 1017-19 (finding that defendants prospectuses adequately disclosed risk factors, and citing with approval the Second Circuit's reasoning in *Kramer v. Time Warner, Inc,* 937 F.2d 767, 774 (2d Cir. 1991), in which the Second Circuit reasoned that "a plaintiff whose complaint alleges that such documents are legally deficient can hardly show prejudice resulting from a courts' studying of the documents."); *see also In re BMC*, 183 F. Supp. 2d at 884 (noting that in Lovelace, "the court specifically considered disclosures from the defendant's 1991 and 1992 prospectuses to defeat the plaintiff's claim of nondisclosure of business risks . . . .").

Even if the Officer Defendants had asserted impermissible facts in the Joint Disclosure Brief, the remedy would be to disregard the factual arguments, not to strike the brief. *Haack v. Max Internet Communications, Inc.,* 2002 WL 511514, at *2 (N.D.Tex. Apr. 2, 2002)(where the challenged exhibits do not play a dispositive role in the court's decision on a motion to dismiss, a motion to strike is moot.); *In re E. Spire Communications, Inc. Sec. Litig.,* 127 F. Supp. 2d 734, 751 (D. Md. 2001) (denying as moot a motion to strike exhibits because the court did not consider them on motion to dismiss).

A. Plaintiffs Ignore the Relevant Disclosures Made by Enron.

Plaintiffs claim that the Officer Defendants in their Joint Disclosure Brief improperly attacked Plaintiffs' "veracity." Plaintiffs cite four examples of these "veracity" attacks from the 245 page Joint Disclosure Brief; however, even these few examples ignore the disclosures that were actually made. First, Plaintiffs characterize the Consolidated Complaint as alleging that "investors were not informed of the risks associated with Enron's hedging activities." Motion at 4. In their motions to dismiss, the Officer Defendants argue these allegations are not true and detail the disclosures given by Enron about related party hedging and the risks and contingent liabilities associated with those transactions. Joint Disclosure Brief at 21-28. The issue could not be more fundamental or more simple: Plaintiffs claim that hedging disclosures were not made; Defendants say the disclosures were made. It is appropriate for the Court to decide that fundamental dispute on motions to dismiss, and consideration of the disclosures is essential to the task.

In their second "example," Plaintiffs' Motion states, "[p]laintiffs allege Enron lied about the number of customers and transactions at Enron's broadband services, claiming it has 16 million customers who in fact belonged to other ISPs, not Enron." Motion at 5. The alleged lie occurred, Plaintiffs say, in an analysts' conference presentation, but Plaintiffs ignore the transcript of the analysts' conference referenced by Plaintiffs and cited by the Officer Defendants, which transcript shows that no statement regarding the number of Enron Broadband Services' customers was made. Joint Disclosure Brief at 148. This example illustrates the reason that Rule 9(b) and the PSLRA require a plaintiff to identify with particularity the source of the statements that it contends establish securities fraud.[3] Otherwise, plaintiffs could pursue a securities fraud claim based on unsupported

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[3] Plaintiffs do not respond to the Officer Defendants' argument that Plaintiffs' allegations lack specificity. Joint Disclosure Brief at 148-49.

or even fictitious statements incapable of rebuttal by any information that was actually disseminated into the market. Again, the issue and its resolution are straightforward. The Plaintiffs cannot assert something was said at a recorded meeting, fail to identify the obvious source of its claim as the transcript, and then prevent the Court from considering the transcript of the meeting. *See* discussion at section III below.

Plaintiffs' third "example" relates to their allegations that Chewco, LJM1 and LJM2 were used to conceal "very large" losses from Enron's merchant activities. In the Joint Disclosure Brief, the Officer Defendants pointed to specific Enron disclosures about these entities and argued that potential "losses" were not concealed. The Plaintiffs describe the Officer Defendants' response that the allegation "is simply wrong" as bare and unsubstantiated. Motion at 5. This description mischaracterizes the Officer Defendants' argument. The Officer Defendants' position is clear: deconsolidated does not equate with "undisclosed." Plaintiffs' position seems to be the opposite, and they would have the Court not consider the public disclosures establishing Defendants' point. Plaintiffs do not address and fail to inform the Court that the Officer Defendants' statement was (1) in the context of a broader argument that the Consolidated Complaint lacked particularity on the matters alleged and (2) that Enron's disclosures, in fact, establish that the alleged debt was not concealed. For example, the Officer Defendants show that (1) Enron's disclosures told investors that the related party hedges "offset market value changes of certain merchant investments and price risk management activities;" (2) where investors could find these losses and the other effects of these transactions in Enron's Forms 10-K; and (3) that the related party hedges were collateralized with million of shares of Enron stock that had been contributed to these entities by Enron. SEC App. Tab 15 at 95-96. The Officer Defendants contend that, where the disclosures establish that the facts

Plaintiffs claim were concealed were actually revealed, the Consolidated Complaint cannot state a claim for securities fraud.

Plaintiffs' last example challenges the Officer Defendants' statement that Plaintiffs "misstate" what was "involved in and disclosed about" the Raptors. Motion at 5. Plaintiffs support this challenge by relying on a statement from the Powers Report – a statement *outside* the Consolidated Complaint – in an improper attempt to amend the Consolidated Complaint: "Enron used the extremely complex Raptor structure finance vehicles to avoid reflecting losses in the value of some merchant investments in its income statement." Powers Report at 97.[4] Given that many appropriate accounting procedures allow companies to avoid reflecting losses without committing fraud, this statement does not support a fraud allegation.

B. The Court May Evaluate the Adequacy of Enron's Disclosures Under Rule 12(b)(6).

Plaintiffs next argue that the Court must disregard consideration of the adequacy of Enron's disclosures because adequacy questions are "inherently factual." Motion at 5. In an effort to justify striking the Joint Disclosure Brief, Plaintiffs claim "[i]mproper fact arguments permeate the entire 'joint disclosure' brief,'" but then cite only eleven "improper fact arguments." This is hardly "permeat[ing]" the entire 245 page Joint Disclosure Brief. To support their position, Plaintiffs incorrectly rely on *Lone Star Ladies Inv. Club v. Schlotzsky's, Inc.*, 238 F.3d 363 (5th Cir. 2001), which applies only to dismissal motions brought under the Securities Act of 1933, not motions brought under the more stringent pleading requirements of the Securities Exchange Act of 1934. *Id.* at 369 ("The lower threshold of liability under section 11 and 12 of the 1933 Act as compared to the

[4] Plaintiffs rely heavily on the Powers Report in their Motion/Objection. As set forth in section II B *supra,* the Powers Report cannot be properly considered because the Plaintiffs did not attach it or incorporate it into the Consolidated Complaint.

1934 Act here matters a great deal."); *see also Kurtzman v. Compaq Computer Corp., et. al.,* Civil Action No. H-99-799 (S.D. Tex. April 1, 2002) slip op. at 92 ("These warnings demonstrate, contrary to Turner's allegations, that Compaq did not conceal the specific risks arising from competition, erroneous forecasting of end-user demand . . . [t]hese cautionary warnings are meaningful . . . .").

Plaintiffs' allegations regarding the Officer Defendants' factual arguments also take the Officer Defendants' statements out of context. For example, Plaintiffs reassert their allegation that Enron "concealed" (*i.e.*, failed to disclose) price triggers in its financial arrangements. Motion at 5. The Officer Defendants' inclusion of statements from Enron's financial statements showing where and how these price triggers were disclosed constitute what Plaintiffs call "improper" fact allegations. *See* Joint Disclosure Brief at 14, 25-27. The notion that the law would not permit the Court to consider these disclosures in this context cannot be taken seriously.

III. THE TWO ANALYSTS' CONFERENCE CALL TRANSCRIPTS AND RELATED POWERPOINT PRESENTATION SHOULD NOT BE STRICKEN.

Of 163 exhibits attached to the Joint Disclosure Brief, Plaintiffs seek to strike two analysts' conference call transcripts and a related PowerPoint presentation because (1) the documents are "outside" the Consolidated Complaint and (2) are not subject to judicial notice.[5] Although Plaintiffs refer to and quote from the conference calls and PowerPoint presentation in the Consolidated Complaint (Motion at 9; NCC ¶¶ 214(I), 329), Plaintiffs claim that the transcripts cannot be used because Plaintiffs do not identify the transcripts specifically. Plaintiffs further argue that the Officer Defendants' inclusion of complete transcripts is "egregious" (Motion at 9), presumably because they

[5] Plaintiffs do not challenge the authenticity of the transcripts and slides and do not identify a single inaccuracy.

show that some of Plaintiffs' selective quotes were wrong, were not made or were taken out of context.

Plaintiffs' use of allegedly misleading statements from these conference calls and slides in support of their fraud claims allows, indeed, requires the Court to review these transcripts and the PowerPoint slides under the PSLRA and the incorporation by reference doctrine, which enables a court to determine whether a complaint meets the stringent requirements of the PSLRA. The rule prevents a plaintiff from "spinning" the meaning of selected documents or selected portions of documents by ensuring that the defendant and, more importantly, the court have the opportunity to review and analyze the document utilized as well as other relevant documents. *See Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1220 (1st Cir. 1996)("Were the rule otherwise, a plaintiff could maintain a claim of fraud by excising an isolated statement from a document and importing it into the complaint, even though the surrounding context imparts a plainly non-fraudulent meaning to the allegedly wrongful statement."); *Sheppard v. Texas Dep't of Transp.,* 158 F.R.D. 592, 595 (E.D. Tex. 1994) (stating in a non-securities fraud lawsuit that "when a plaintiff does not attach a pertinent document to the complaint and the document contradicts the complaint, a 'defendant may introduce the exhibit as part of his motion attacking the pleading.'"). The rule also prevents the plaintiff from foreclosing further examination of a document through "artful pleading." *In re Silicon Graphics, Inc. Sec. Litig.*, 970 F. Supp. 746, 759 (N.D. Cal. 1997) *aff'd,* 183 F.3d 970 (9th Cir. 1999)("Plaintiffs cannot preclude consideration of defendants' SEC forms by artful pleading.")

The Fifth Circuit has adopted the incorporation by reference doctrine. *See Collins v. Morgan Stanley Dean Witter,* 224 F.3d 496, 498-99 (5th Cir. 2000)("'[d]ocuments that a defendant attaches to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are central to her claim.' . . . In so attaching, the defendant merely assists the plaintiff in establishing the basis of the suit, and the court in making the elementary determination of whether a claim has been stated."); *Lovelace,* 78 F.3d at 1018 (even if not attached, a court can consider "documents . . . incorporated in the complaint"). This Court has applied the doctrine by refusing to strike similar analysts' conference transcripts under the incorporation by reference doctrine and the PSLRA. *In re BMC,* 183 F. Supp. 2d at 884. The majority of other courts have also considered transcripts of conference calls on motions to dismiss where allegedly misleading statements were made in the conference calls themselves.[6]

IV. THE OFFICER DEFENDANTS HAVE NOT WAIVED THE AUTOMATIC DISCOVERY STAY.

Plaintiffs' argument that the automatic discovery stay has been waived rewrites the procedural rules by contending that filing motions to dismiss incorporating evidence that was explicitly relied on in the Consolidated Complaint waives the automatic stay of discovery under the PSLRA. Motion at 10-11. In support of their argument, Plaintiffs cite purportedly "analogous" cases involving waiver of evidentiary privilege by voluntary partial disclosure and waiver of qualified immunity by submitting evidence in support of immunity while using immunity to avoid discovery. Not one of those cases involves an explicit statutory policy prohibiting discovery until determination of the adequacy of the complaint.

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[6] *See In re Staffmark, Inc. Sec. Litig.,* 123 F. Supp. 2d 1160, 1163 n.2 (E.D. Ark. 2000)(considering conference call transcripts on motion to dismiss); *In re Milestone Scientific Sec. Litig.*, 103 F. Supp. 2d 425, 450 n.15, 464 n.25 (D.N.J. 2000)(considering conference call transcripts on a motion to dismiss *even where the transcript differed substantively* from the statements as alleged by the plaintiffs)(emphasis added); *Wallace v. Sys. & Computer Tech. Corp.,* No. Civ. A. 95-CV-6303, 1997 WL 602808 (E.D. Pa. Sept. 23, 1997)(considering an *unauthenticated* conference call transcript where Plaintiffs' claims were based on statements made during the conference call)(emphasis added).

In enacting the PSLRA, Congress provided that the adequacy of the complaint would be determined by motion to dismiss prior to the commencement of discovery. *See* 15 U.S.C. § 78u-4(b)(3)(B). Plaintiffs ask this Court to eviscerate the Congressional enactment and the policy behind it by holding that a defendant who files a motion to dismiss incorporating evidence relied on in the complaint waives the discovery stay. In reality, "plaintiffs seek to lift the [discovery] stay for the sole purpose of uncovering facts to support the fraud allegations in the Complaint." *Faulkner v. Verizon Communications, Inc.*, 156 F. Supp. 2d 384, 402 (S.D.N.Y. 2001). However, "Congress clearly intended that complaints in these securities actions should stand or fall based on the actual knowledge of the plaintiffs rather than information produced by defendants after the action has been filed." *Medhekar v. United States Dist. Court for the N. Dist. of Cal.*, 99 F.3d 325, 328 (9th Cir. 1996). *See also Lapicola v. Alternative Fuels, Inc.*, No. 3-02-CV-0299-G, 2002 WL 531545, at *1-2 (N.D.Tex. Apr. 5, 2002)(the PSLRA was designed (1) to prevent the imposition of any unreasonable burden on a defendant before disposition of a motion to dismiss; and (2) to avoid the situation in which a plaintiff sues without possessing the requisite information to meet the heightened pleading requirements of the PSLRA, then uses discovery to acquire that information and resuscitate a complaint that is otherwise subject to dismissal.")

V. THE JOINT DISCLOSURE BRIEF CHALLENGES THE ADEQUACY OF THE CONSOLIDATED COMPLAINT.

A. Plaintiffs Do Not Plead Particular Facts as to Specific Officer Defendants.

The central theme of the Joint Disclosure Brief and more generally, the motions to dismiss, is that Plaintiffs did not plead the alleged accounting and business unit fraud with particularity. By way of example, Defendants contend that Plaintiffs first failed to identify transactions as fraudulent. Second, when transactions were identified, Plaintiffs failed to plead specific facts regarding why the transactions were fraudulent. Third, they failed to plead particular facts as to who within Enron was aware of or involved in any alleged fraud. As to the Officer Defendants, Plaintiffs never allege (1) which ones knew certain facts, (2) what each allegedly knew, (3) how such knowledge was obtained, and (4) when it was obtained by any particular Officer Defendant. The Officer Defendants are not "the Company," and simply alleging what Enron did or did not do does not implicate the individual Officer Defendants. Therefore, Plaintiffs fail to connect any Officer Defendant to the supposed fraudulent scheme.

B. The Joint Disclosure Brief Accurately Incorporates Enron's Financial Disclosures.

Stung by the realization that their pleading failed to meet the particularity requirements of the PSLRA, Plaintiffs resort to twisting and clouding the disclosures actually made by Enron, and then inappropriately attempt to supplement the Consolidated Complaint by referencing additional sources, such as the Powers Report and Congressional Testimony, which were not used but were available when the Consolidated Complaint was drafted. Since the Joint Disclosure Brief accurately sets out the relevant Enron disclosures that counter Plaintiffs' allegations of lack of disclosure, the Officer Defendants will not rehash the Joint Disclosure Brief by responding item by item to Plaintiffs' objections. However, because Plaintiffs' references to the Powers Report, Congressional Testimony and other materials could have been included in the Consolidated Complaint but were not, the references should not be considered because they amount to an impermissible amendment or supplement to the Consolidated Complaint. *See In re BMC*, 183 F. Supp. 2d at 915, *citing In re Baker Hughes Sec. Litig.*, 136 F. Supp. 2d 630, 646-47 (S.D. Tex. 2001), *aff'd*, 2000 WL 108944

(5th Cir. May 21, 2002)("[I]t is axiomatic that the Complaint cannot be amended by the briefs in opposition to a motion to dismiss.")[7]

1. Plaintiffs' Use of the Powers Report Is Misleading.

If the Court considers any part of the Powers Report not cited in the Consolidated Complaint, it must at least consider the context of the selective quotes relied on by Plaintiffs. For example, Plaintiffs use a quote from page 197 of the Powers Report to argue that (1) the Powers Report concludes that Enron made material misrepresentation and omissions, (2) the Powers Report paragraph regarding "footnote disclosures" "hardly squares with defendants' assertion 'the 'billions' in debt that Plaintiffs claim was 'hidden' was disclosed in the notes,'" and (3) the Powers Report conclusions were credible because the committee was comprised of and advised by competent experts.

What Plaintiffs do not point out to the Court is that this quote actually: (1) refers only to the related party footnotes in the financial statements and not the myriad other events or circumstances challenged by Plaintiffs; (2) the report does not conclude that the disclosures were legally insufficient; (3) it does not conclude that a material misrepresentation or omission was made regarding related party transactions; (4) it does not conclude that Enron committed fraud; (5) it does not criticize the debt disclosure per se, it suggests only that the structure of some of the related party transactions were not communicated clearly in hindsight; and (6) it is irrelevant to the Officer

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[7] Plaintiffs also try to incorporate into its Motion and Objection the 32 page "Statement of Facts" contained in the Memorandum of Points and Authorities in Opposition to the Outside Directors' Motion to Dismiss. Motion at 2. The "Statement of Facts" contains new factual allegations and references nearly thirty new fact exhibits. Plaintiffs' effort to amend the Consolidated Complaint must be considered for what it is: an admission that the Consolidated Complaint fails to state a fraud claim.

Defendants' reference that the financial statements for 2000 disclosed $66 billion in liabilities, including debt and contingent exposures.

2. The Restatement Is Not an Admission of Securities Fraud and Is Not Sufficient, of Itself, to Overcome a Motion to Dismiss.

As with the Consolidated Complaint, Plaintiffs inappropriately equate Enron's restatement of its financial statements to fraud. Objection at 13. Plaintiffs claim that the restatement is an admission that the prior financial statements were materially false based on facts Enron management had when the financial statements were originally issued. Additionally, by including the restatement information in the Consolidated Complaint, Plaintiffs claim that they have "described in detail the falsifications of Enron's financial statements." *Id.*

The mere fact that there has been a restatement does not suffice to state a claim of securities fraud. *In re Baker Hughes,* 136 F. Supp. 2d at 648-49 (allegations of accounting improprieties and restated financial figures insufficient to establish scienter); *Mortenson v. Americredit Corp.,* 123 F. Supp. 2d 1018, 1025-26 (N. D. Tex.) *aff'd,* 240 F.3d 1073 (5th Cir. 2000)(restatement does not create a strong inference of fraud). Instead, pleadings regarding restatements are subject to the standards of Rule 9(b) and the PSLRA. *See In re Waste Management*, No. H-99-2983, Slip. Op. at 185 (S.D. Tex. Aug. 16, 2001)(a plaintiff must specify what the unreasonable practices were and how they distorted the disclosed data in transaction specific detail); *Chalverus v. Pegasystems, Inc.*, 59 F. Supp. 2d 226, 233 (D. Mass. 1999). Plaintiffs' merely repeating the information and the amounts of the restatement that Enron disclosed in its November 8, 2001 Form 8-K fails to satisfy the legal standards for stating a fraud claim. Moreover, the Consolidated Complaint adds issues far beyond those identified in the restatement.

3. The Officer Defendants' Assertions of the Amount of Enron Liabilities Disclosed Are Accurate.

Plaintiffs contend that the Officer Defendants misled the Court by stating that Enron disclosed over $66 billion in "debt" in its financial statements, when Enron only considered $10.229 billion as debt in its November 8, 2001 Form 8-K. Objection at 14. Plaintiffs' further assert that the Officer Defendants categorized every liability item as "debt." *Id.* On the contrary, it is Plaintiffs' "spin" on the Officer Defendants argument that is misleading and wrong. The Officer Defendants represented to the Court that Enron disclosed $66 billion in "*liabilities*, including debt and other contingent exposures"(emphasis added). The context of this discussion is the Officer Defendants' argument that unconsolidated does not mean undisclosed. Plaintiffs argue that any unconsolidated entity involves "hidden debt." Much of the "hidden debt" that Plaintiffs alleged involved exposures that were contingent at the time the financial statements were prepared and, thus, were not technically debt. That a contingent exposure may ultimately become a debt if the contingent factors materialize does not mean that the debt was hidden or improperly classified. A reasonable investor may consider the likelihood of the contingent events occurring in assessing the overall financial risk of investment. More to the point, the disclosures were often about deconsolidated entities that are discussed in Enron's public disclosures, adding support to Defendants' argument that unconsolidated does not mean undisclosed.

Many of Plaintiffs' counter arguments to Enron's $66 billion liability disclosure are answered by the reference to liabilities and potential exposures. For example, Plaintiffs claim that an investor could not have understood the references to minority interest in Note 8 of the Annual Report to involve debt. But Plaintiffs' argument begs the question – the minority interests were not debt, but contingent exposure. Plaintiffs correctly cite the disclosure in Note 8 that "absent certain defaults or other specified events, Enron has the option to acquire the minority holders' interest in these partnerships." Note 8 goes on to say, however, that if Enron does not acquire those interests, the minority interest holders may cause the entities to liquidate their assets and dissolve. This disclosure informed investors that the amount of the investment was at risk, creating a potential exposure that an investor might want to consider.

Plaintiffs further question the Whitewing and Azurix "debt" disclosure in Note 10 of the Annual Report. Again, as explained more fully on page 13 and 14 of the Joint Disclosure Brief, that disclosure reflected a contingent stock liability that might mature in the future and provided information about how the maximum exposure could be calculated. The same analysis applies to the derivative instruments exposure questioned on page 16 of the Response. *See* Joint Disclosure Brief at 14-15. Plaintiffs ignore the explanations in the Joint Disclosure Brief.

Plaintiffs' challenge to the $4 billion exposure calculated from Note 15 of the Annual Report suffers from the same problem. Objection at 17. Plaintiffs must read the Note to understand its content. The $4.072 billion from Note 15 is calculated as follows: (1) future minimum payments under firm transportation agreements include $91 million, $88 million, $89 million, $85 million and $77 million for 2001 through 2005 and $447 million for later years; (2) guarantees under leases totaling $556 million; (3) letter of credit guarantees for unconsolidated equity affiliates totaling $264 million; (4) guarantees of certain other liabilities of unconsolidated equity affiliates totaling $1,863 million; (5) other lease guarantee obligations totaling $386 million; and (6) a guarantee of 89.9 percent of $140 million in certain power project costs (totaling $125.9 million). The other debt that

Plaintiffs claim was hidden and not included in any of the debt disclosures cited by Defendants is, in fact, addressed in the Joint Disclosure Brief and in some cases several places.[8]

4. Plaintiffs Fail to Respond to the Substantive Pleading Defects Addressed in the Joint Disclosure Brief.

Plaintiffs' superficial, selective responses to the adequacy of Enron's disclosures obscures another problem that Plaintiffs fail to address. Plaintiffs again do not plead facts that specify a fraud claim with particularity as required by the PSLRA. For example, as detailed in the Joint Disclosure Brief, not only did the Officer Defendants recite extensive examples of related party and other disclosures related to Enron's partnerships and SPEs, the Officer Defendants detail Plaintiffs' failure to plead facts that support a claim that the partnerships and SPEs should have been consolidated. Debt of entities that the relevant accounting standards did not require to be consolidated on Enron's balance sheet were not "hidden." For several entities, like Firefly and JV-Company, Plaintiff pleaded no facts that, if proved, would require consolidation.[9] It is also not enough for Plaintiffs to simply allege facts, as in the case of Chewco, that consolidation was required. To state that Enron improperly did not consolidate Chewco is not enough to plead fraud. *Lovelace,* 78 F.3d at 1020 (accounting negligence and differences of business judgment do not violate the securities laws). Plaintiffs had to go further and plead particular facts indicating that the failure to consolidate a

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[8] *See, e.g.,* Chewco, Joint Disclosure Brief at 93-94; Mahonia, CitiGroup, CS First Boston and Connecticut Resources, Joint Disclosure Brief at 68-69. Matters related to the Sequoia, Choctaw, Cherokee and Cheyenne transactions (Objection at 17) were not alleged against the Officer Defendants, only JP Morgan. NCC ¶ 659.

[9] Another example of Plaintiffs' failure to read Enron's disclosures is the statement that "defendants claim 'GAAP prevented LJM1 and LJM2 from being consolidated onto the balance sheet . . . [b]ut this is the opposite of what Enron admitted to in its 11/8/01 Form 8-K . . . ." (emphasis original). Objection at 18. Enron's "admission" in the Form 8-K was not that LJM1 and LJM2 should have been consolidated, only that LJM1's SPE SwapSub should have been consolidated. SEC App. Tab 19.

particular partnership or SPE was the result of fraud. Plaintiffs never met this burden in the Consolidated Complaint and, instead of trying to convince the Court that they did indeed plead fraud with particularity, Plaintiffs obfuscate their pleading defect by claiming that the Officer Defendants did not adequately "respond" to their allegations. *See e.g.,* Objection at 17-18.

Plaintiffs' discussion of the Osprey and Marlin transactions on page 18 and 19 of their Objection is another representative example of Plaintiffs' avoidance of their pleading defects. In the Joint Disclosure Brief, the Officer Defendants pointed out that Plaintiffs never expressly assert that the Enron accounting for Marlin, Osprey and Whitewing was "fraudulent." Joint Disclosure Brief at 17. Plaintiffs do not contradict this point. Defendants state that Plaintiffs fail to apply the correct accounting standard in their discussion of Whitewing or Marlin or plead any facts that would support a claim that the accounting standards were misapplied by Enron. Plaintiffs' Objection does nothing to clarify this pleading defect. Plaintiffs also never state how the allegedly concealed "debt" should have been disclosed: they do not clarify whether certain Marlin and Whitewing guarantees should have been consolidated or whether the entities themselves should have been. Because these and other allegations about Whitewing and Marlin are vague and unspecific, and because Plaintiffs never allege fraud or attribute knowledge of fraud to any of the Officer Defendants, Plaintiffs pleading fails for lack of particularity. Plaintiffs ignore these deficiencies. Finally, as the Joint Disclosure Brief demonstrates, the salient facts about these unconsolidated entities were disclosed. *See* Joint Disclosure Brief at 13-19.

5. Plaintiffs' Allegations About Related Parties and Hedging Repeat Old Arguments.

As they do throughout the Objection, Plaintiffs attempt to bolster their deficient Complaint by quoting extensively from the Powers Report. But even with that, the best case that Plaintiffs can make about Enron's hedging with related parties is that they were not "true economic hedge[s]" or as Plaintiffs spin it "phony hedges." Plaintiffs' "case" does not plead a fraud claim and begs the real question – whether the structure of the related party hedges were disclosed. Enron disclosed that related party hedging was being done with Enron stock, Joint Disclosure Brief at 24-25, and Plaintiffs admit that fact. Objection at 21. If Enron disclosed that it was hedging these transactions with Enron stock, it is not fraud if they were not "true economic hedges" *because* the hedge used Enron stock.

6. Enron's Related Party Disclosures Properly Invoked Safe-Harbor Cautions.

Plaintiffs' pleading defects are never more pronounced than in their attempt to attack Enron's safe-harbor protections. Plaintiffs' Objection is silent when confronted with what they failed to plead.[10] Given that, Plaintiffs' Objection (1) substantially fails to respond to the related party and safe-harbor arguments in the Joint Disclosure Brief, (2) attempts to supplement the Consolidated Complaint with new allegations, namely that "Enron Management" knew the terms of the LJM transactions to be unreasonable, and (3) merely reasserts Consolidated Complaint allegations that ignore the context of Enron's related party disclosures.

The Officer Defendants present Enron's related party disclosures in detail from page 21 through page 44 of the Joint Disclosure Brief. Plaintiffs' response fails to address many of Enron's disclosures in context and never suggests which of Enron's related party disclosures were misleading or inadequate. Plaintiffs also never explain how the significant related party disclosures made by

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[10] Namely, (1) what specific material "facts" were allegedly undisclosed, (2) who knew those facts, (3) when those "facts" became known to Enron or to any individual defendant, (4) why those "facts" were material to a reasonable investor, and (5) how those "facts" should have been, but were not, disclosed. *See Williams v. WMX Technologies, Inc.*, 112 F.3d 175, 178 (5th Cir.), *cert denied*, 522 U.S. 966 (1997); *Nathenson v. Zonagen,* 267 F.3d 400, 412-13 (5th Cir. 2001).

Enron did not provide investors with the information Plaintiffs claim those investors needed to make informed investment decisions. Plaintiffs still do not identify the related party transactions that they claim were fraudulent, explain why the few identified transactions were material or fraudulent, or whether any Officer Defendant knew it was fraudulent at the time.

Having failed to address it in the Consolidated Complaint, Plaintiffs now allege that "management knew these [LJM] transactions were not reasonable compared to similar deals with unrelated third parties." Objection at 23. Plaintiffs cannot supplement their Complaint to add this allegation through their response. Even if they could, the allegation would not help Plaintiffs' case. The allegation is conclusory and lacks the pleading particularity required to state a claim. Plaintiffs support their claim by stating the deals were structured to benefit certain insiders and favored bankers, but Plaintiffs never (1) identify these LJM "deals," (2) plead facts relating to the deal structures or (3) identify any individual Officer Defendant that supposedly knew the details of the unidentified transactions, including how they were structured, the banking arrangements or the alleged benefits to certain insiders. The Enron disclosure that management "believed" the terms of the related party transactions were "reasonable" is also too vague and general to support a fraud claim, (Joint Disclosure Brief at 39), and the disclosures were, in any event, forward looking statements protected by the PSLRA's safe harbor (Joint Disclosure Brief at 38).[11]

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[11] Plaintiffs' statements that Enron did not provide appropriate safe harbor disclosures in its analysts' conference calls has no basis. Plaintiffs failed to provide a transcript or any other evidence that no such disclosures were made. Even if there was no cautionary language on these calls, the PSLRA also requires Plaintiffs to prove that the forward-looking statement was made or approved by an executive officer "with actual knowledge by that officer that the statement was false or misleading." 15 U.S.C. § 77z-2(c)(1)(B)(ii), 78u-5(c)(1)(B)(ii); *see, e.g.*, *Harris*, 182 F.3d at 803 ("Even if the forward-looking statement has no accompanying cautionary language, the plaintiff must prove that the defendant made the statement with 'actual knowledge' that it was 'false or misleading.'"); *In re Vantive Corp. Sec. Litig.*, 110 F. Supp. 2d 1209 (N.D. Cal. 2000), *aff'd* 283 F.3d 1079 (9th Cir. 2002) (same). Plaintiffs have not met this pleading burden.

7. Plaintiffs Do Not Plead With Particularity Fraud Related to Chewco, LJM1, LJM2 or the Application of GAAP.

Throughout the Joint Disclosure Brief, the Officer Defendants demonstrate that Plaintiffs' allegations that accounting rules were violated are inadequately pled. Plaintiffs counter the Officer Defendants by relying, not on accounting rule language, but on a *Newsweek* article and excerpts from the Powers Report. Objection at 27-28. Plaintiffs discuss basic accounting rules regarding consolidation of SPEs without regard to specific facts regarding Enron related SPEs. Furthermore, Plaintiffs avoid the discussion of Chewco in the Joint Disclosure Brief, asserting instead that Chewco is "illustrative" of the accounting and treatment of other SPEs. As set forth in the Joint Disclosure Brief, Plaintiffs' arguments are unavailing.

Plaintiffs continue to rely on conclusory opinion rather than fact, such as their statement that "Enron management was widely aware of these problems." Objection at 28. Even if the Court were to allow consideration of the Powers Report, its conclusions – after investigation of the facts – were not nearly as bold and careless as Plaintiffs. For example, contrary to Plaintiffs' claim that Enron Management was widely aware of the problems [with Chewco], the Powers Report states:

> [We] have been unable to determine why the parties utilized a financing structure for Chewco that plainly did not satisfy the SPE non-consolidation requirements. Enron had every incentive to ensure that Chewco was properly capitalized. . . . We do not know whether Chewco's failure to qualify resulted from bad judgment or carelessness on the part of Enron employees or Andersen . . . .

Powers Report at 54.

While all of Plaintiffs' responses to Chewco, LJM1 and LJM2 contain mischaracterizations or lack substance, a few representative examples will be addressed here. Plaintiffs claim that the Officer Defendants misquote Consolidated Complaint ¶ 385 by omitting the words Chewco, LJM1 and LJM2, when they argue that the pleading lacks particularity due to a failure to plead specific transactions. Objection at 28. But Plaintiffs misconstrue their own pleading. Plaintiffs allege that "[t]he partnerships – Chewco, LJM1 and LJM2 – ***were used by Enron management to enter into transactions that it could not, or would not, do with unrelated commercial entities . . .*** " NCC ¶ 385 (emphasis in original). As the Officer Defendants assert, the transactions complained of are not named – only the entities allegedly entering into them – Chewco, LJM1 and LJM2. Naming the parties to an allegedly fraudulent transaction is not enough to plead fraud; the Plaintiffs must also identify the questionable transactions. Plaintiffs' failure to do so prevents their compliance with the PSLRA.

Plaintiffs further claim that their pleading is adequate as to Cuiaba, ENA CLO, Nowa Sarzyna, Aryan, MEGS, Yosemite, Backbone and fourteen other unnamed "manipulative transactions." Objection at 29. Plaintiffs' contention lacks the same substance missing in the Consolidated Complaint. Plaintiffs still fail to specify why each was allegedly "manipulative," how the particular transaction was material to an investor, where it should have been disclosed, and when (and to whom) it was known that the transaction had created adverse outcomes for Enron. Furthermore, not only do Plaintiffs not identify even one individual Officer Defendant who knowingly participated in the unspecified "manipulation," Plaintiffs admit that they can make no such allegation: "[t]he fact the individual defendants' participation in this transaction is not identified at this part of the CC does not indicate they were not involved." Objection at 29. The PSLRA prevents allegations of guilt by association or guilt by speculation. The fact that certain Officer Defendants could have known or may have been involved is not enough to prevent dismissal of Plaintiffs' claims.

8. Plaintiffs' Discussion of the New Power IPO Fails to Address Their Failure to Plead Fraud.

Consistent with their general style of response, Plaintiffs ignore the determinant issue in discussing the New Power IPO. Objection at 32-34. Plaintiffs do not defend their failure to plead that any Officer Defendant knew, at the time Enron entered into the New Power transaction, that the structure was fraudulent. No Officer Defendant is even mentioned in the New Power-Raptor III discussion, much less accused of fraud. The remainder of Plaintiffs' argument is fully countered in the Joint Disclosure Brief. *See* Joint Disclosure Brief at 64-66.

9. Plaintiffs Do Not Defend Their Pleading Deficiencies Related to the Mahonia, Delta and Connecticut Resources Transactions.

Plaintiffs' response to the fact that they did not plead an accounting violation or any facts detailing which of the individual defendants were involved in the alleged fraud in connection with Mahonia is to argue that a judge in New York found that "taken together, then, these arrangements now appear to be nothing but a disguised loan." Objection at 34. Interestingly, Plaintiffs do not actually cite the case, possibly because the case does not find that Enron committed fraud, it merely denies JP Morgan's Motion for Summary Judgment in a promissory note collection case to allow prosecution of a fraudulent inducement defense. *See JP Morgan Chase Bank v. Liberty Mut. Ins. Co.,* 189 F. Supp. 2d 24 (S.D.N.Y. 2002).

The pleading standards of the PSLRA are far stricter than the pleading requirement of a fraudulent inducement defense to a collection case, and Plaintiffs do not even try to meet the PSLRA standard. For example, in their Objection the Plaintiffs still do not argue that the accounting for these transactions was fraudulent, only that the transactions were mischaracterized as forward-sales contracts by Enron. Even if Enron had mischaracterized the transaction that would not necessarily be fraud. Negligent accounting could cause a transaction mischaracterization and that is not enough to plead fraud. *Lovelace*, 78 F.3d at 1020 (accounting negligence and differences of business judgment do not violate the securities laws). Plaintiffs' *New York Times* quote that Enron "took advantage of accounting rules" (Objection at 34) does not allege fraud. To the contrary, the quote recognizes that Enron was within the letter of the accounting rules in categorizing the transactions.

Plaintiffs also do not identify a single perpetrator of any fraud. Plaintiffs claim that "Enron never intended to deliver the subject commodities under the purported forward-sales contracts." Objection at 34. Plaintiffs do not allege what specific individuals within Enron knew about these contracts, who structured them, who approved them, much less who acted with fraudulent intent or with knowledge of fraud.

10. The Consolidated Complaint Does Not Adequately Plead Fraud Relating to Enron's Use of Mark-to-Market Accounting.

Plaintiffs' attempt to respond to the Joint Disclosure Brief's arguments with regard to mark-to-market ("MTM") accounting in WEOS fails. Plaintiffs do not dispute that the method about which they complain was appropriate and mandated, and that Enron disclosed its use of MTM accounting and the risks and assumptions inherent in its application. Their only contention, that a factual inquiry is required to determine whether Enron "abused" or "misused" MTM accounting, ignores the failure of the Consolidated Complaint to adequately plead facts upon which to base a claim of fraud.

Contrary to the implications of the Consolidated Complaint, Plaintiffs make clear in their Objection that they do not contest Enron's use of MTM accounting. Instead, they concede that EITF No. 98-10 provides the applicable authority for the use of MTM accounting for wholesale trading, and claim that the only issue raised in the Consolidated Complaint is whether Enron "abused" or "misused" that accounting method. Objection at 34-36. Moreover, Plaintiffs *do not contest* that Enron adequately disclosed: (1) that energy trades were recorded using MTM accounting;[12] (2) that the use of MTM accounting required management to make certain assumptions and estimations;[13] and (3) that the use of MTM accounting carried certain risks, the results of which could have a material impact on the financial condition of the company.[14]

Although Plaintiffs acknowledge the propriety of MTM accounting in connection with wholesale trading, and admit that MTM accounting required management to make certain assumptions and estimations, they continue to assert that Enron applied this accounting method improperly. In an attempt to avoid defending the substance of this "real issue," as raised in the Consolidated Complaint, Plaintiffs now contend that this is a "*factual question* that is *not* appropriately raised [on a motion to dismiss], nor can it be fairly and adequately determined without the benefit of discovery." Motion at 7 (emphasis in original). This circular argument, however, assumes that Plaintiffs have raised sufficient facts to state a claim in the first instance.

It is axiomatic that even "factual questions" are appropriately dismissed under Rule 9(b), Rule 12(b)(6), and the PSLRA, where, as here, the complaint fails as a matter of law to adequately plead a claim for fraud. *See, e.g., In re Penn Treaty American Corp. Sec. Litig.*, No. 01-1896, 2002 WL 1000265, at *4 (E.D. Pa. May 15, 2002) ("courts will ... grant a defendant's 12(b)(6) motion

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[12] *See* Joint Disclosure Brief at 73-75. Plaintiffs explicitly admit this point. *See* Objection at 36 (nowhere in the consolidated complaint do "plaintiffs merely allege Enron was concealing it used MTM accounting").

[13] *See* Joint Disclosure Brief at 75-78. Plaintiffs do not dispute that disclosures regarding these assumptions were inadequate in any way, and admit that MTM "requires companies to make reasonable assumptions." Objection at 35.

[14] *See* Joint Disclosure Brief at 75-78. Plaintiffs do not dispute that Enron disclosed that the effectiveness of Enron's trading practice – which relied on the assumptions inherent to MTM – could have a material impact on earnings.

[with respect to "fact specific inquiries"] if the alleged misrepresentations or omissions are ... not pled in accordance with Rule 9(b) or the Private Securities Litigation Reform Act of 1995."); *Angres v. Smallworldwide PLC*, 94 F. Supp.2d 1167, 1172 (D. Colo. 2000) (same). Thus, Plaintiffs must demonstrate how the allegations in the Consolidated Complaint are sufficient under the PSLRA and Rule 9(b) to plead fraud – and cannot rest solely on their assertion that the proper use of an accounting method is a factual inquiry.

Plaintiffs do not defend their numerous vague and conclusory allegations that Enron "misused" or "abused" MTM accounting – as the mere repetition of those labels are insufficient under the PSLRA to plead fraud.[15] Rather, they claim that their allegations that Enron "moved the curve" and made "what it knew were unreasonable assumptions so that earnings would appear more favorable," are sufficient to state a claim for fraud. Objection at 35-36. Yet, these sweeping conclusions are bereft of support from adequate factual allegations in the complaint. In pages 41-42 of their Objection, Plaintiffs cite to only three instances in the Consolidated Complaint where they have even attempted to specify the who, what, where, why, when and how of Enron's "abuse" or "misuse" of MTM accounting – all of which fall short.

First, Plaintiffs argue that unidentified Enron Defendants committed fraud by picking "the *lowest* consumer-price-index ... and the *highest* possible revenue stream escalator...." Objection at 42 (emphasis in original). Plaintiffs, however, cannot point to any specific factual allegations

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[15] *See, e.g., Minger v. Green*, 239 F.3d 793, 799 (6th Cir. 2001) ("[T]he Rules require that we not rely solely on labels in a complaint, but that we probe deeper and examine the substance of the complaint. Indeed, this court has made clear that the label which a plaintiff applies to a pleading does not determine the nature of the cause of action which he states.") (internal quotations omitted); *City of Philadelphia v. Fleming Cos.*, 264 F.3d 1245, 1263 (10th Cir. 2001) ("We decide cases [under the PSLRA] on facts, not labels ... under the PSLRA ... pleading conclusory labels ... will not suffice.").

upon which to reasonably infer that such economic assumptions and valuations were unreasonable, much less knowingly fraudulent. Without such allegations, Plaintiffs have merely alleged that Enron's assumptions and estimations were at worst optimistic and should have been different – but alleging a bad business decision in hindsight is *not* equivalent to alleging fraud. *See, e.g., Melder v. Morris*, 27 F.3d 1097, 1101 n.8 (5th Cir. 1994) ("These allegations boil down to plaintiffs' attempt to chastise as fraud business practices that, in hindsight, might have been more cautious. Misjudgments are not, however, fraud."). This argument is especially unavailing in light of Enron's disclosures concerning the risks related to such assumptions and valuations. *See supra*; *see, e.g., Lovelace*, 78 F.3d at 1019-20 (affirming dismissal of securities fraud claim because company's public filings adequately disclosed that company relied upon the business activities complained of and disclosed the potential material impact the success or failure of such activities could have on the corporation). Beyond this flaw, Plaintiffs ignore the fact that their allegations do not specify who made or approved the allegedly fraudulent assumptions, or when such assumptions were made and with regard to which trades. This lack of specificity, alone, demonstrates the insufficiency of such claims under the PSLRA. *See, e.g., Nathenson*, 267 F.3d at 419 (allegations under the PSLRA must provide specific facts).

Plaintiffs claim that their repeated allegations that unidentified traders "moved the curve" in the 4th Quarter of 1999 and year-end 2000 is sufficient to support a claim under the PSLRA. The deficiency in these allegations is that they fail to specify which traders were involved and who authorized, approved or directed such trades. Having failed to allege "who," they have necessarily failed to plead the requisite scienter necessary to state a claim under §10(b). *See, e.g, Schiller v. Physicians Resource Group, Inc.*, No. Civ. A. 3:97-CV-3158-L, 2002 WL 318441, *10 n.9 (N.D.

Tex. Feb. 26, 2002) ("The complaint fails to identify ... which of the several individual defendants were in possession of this information. Accordingly, to the extent that Plaintiffs attempt to plead scienter ... the court holds that such allegations, without more, are insufficient under the heightened pleading standard of Rule 9(b) and the PSLRA, and thus cannot support a strong inference of fraud."). Moreover, although Plaintiffs' allegations *conclude* that there was "no valid justification" to move the curve as alleged,[16] the claims make no factual allegations to support that conclusion, and, indeed, belie Plaintiffs' implication that any movement of the curve would be, *per se*, fraudulent.

Finally, Plaintiffs make no adequate rebuttal to the Consolidated Complaint's failure to demonstrate how, or to what extent, if any, the allegedly fraudulent assumptions and estimations, or "earnings-curve manipulations," affected Enron's financial disclosures, much less that they made those disclosures materially false and misleading. *See, e.g., Abrams v. Baker Hughes Inc.*, No. 01-20514, 2002 WL 1018944, at *3 (5th Cir. May 21, 2002) (10b-5 claim requires a misstatement or omission of a material fact). For example, while Plaintiffs allege that "Enron moved the curve up $20 million"[17] on an unspecified deal, they do not explain to what extent that allegedly fraudulent act increased Enron's earnings, and therefore have not adequately alleged that a reasonable investor would have been misled. *See, e.g., Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 547 (8th Cir.1997) (overstatement of assets by $6.8 million, representing 2% of company's total assets, immaterial as a matter of law); *Glassman v. Computervision Corp.*, 90 F.3d 617, 633 & n. 26 (1st Cir.1996) (overstatement of revenues by 3%-9% immaterial); *In re Newell Rubbermaid Inc. Sec. Litig.*, No.

[16] *See, e.g.,* NCC ¶300(e)(ii) (cited by Plaintiffs in their Objection at 42).

[17] NCC ¶ 300(e)(ii) (cited by Plaintiffs in their Objection at 42).

9926853, 2000 WL 1705279, at *7 (N.D. Ill. Nov. 14, 2000) (undisclosed expenses of $40 million were immaterial as a matter of law in light of $400 million income). Because Plaintiffs have failed to allege the financial impact of the alleged MTM abuses on Enron's financial position, they have not stated a claim under section 10(b).

11. Plaintiffs Fail to Respond to the Issues Over Impairments and Miscellaneous Accounting Issues.

Plaintiffs largely fail to address the discussion in the Joint Disclosure Brief regarding impairments and miscellaneous accounting issues. The only paragraph in the Objection addressing impairments relates to Azurix, and the arguments that Plaintiffs raise indicate a lack of comprehension of the Officer Defendants' briefing. Objection at 38. Plaintiffs premise their argument by saying "Defendants take [an] inconsistent position" of the application of SFAS No. 121. *Id.* The position is not inconsistent and is explained in the Joint Disclosure Brief at pages 82 to 87. Azurix and Enron were separate companies. Azurix owned assets and Enron held an investment interest in Azurix. Therefore, the impairment test that Azurix applied (SFAS No. 121) was different than the impairment test applied by Enron (EITF 94-3). The need for, amount of and timing of an impairment write down depended on the accounting rule that applied. Plaintiffs never allege that Enron applied the wrong accounting rule, but Plaintiffs' attempt to create a faulty accounting claim based on the Plaintiffs' application of the wrong accounting rule. Like Plaintiffs' argument regarding impairments, Plaintiffs misread the Officer Defendants' briefing on the accounting rules concerning audit adjustments. Objection at 39; Joint Disclosure Brief at 88-89.

12. Plaintiffs Improperly Try to Salvage Their Restatement Allegations by Amending the Consolidated Complaint.

Plaintiffs downplay their fraud allegations related to the restatement, essentially conceding the weakness of their arguments: "[i]t is important to remember the restatement affected only part of Enron's improper accounting." Objection at 39. The Plaintiffs then try to salvage their restatement allegations by quoting Congressional testimony of Thomas Bauer that was not included in the Consolidated Complaint, but was available when it was drafted. Plaintiffs' attempt to amend the pleading through their response is improper. *See In re BMC*, 183 F. Supp. 2d at 915, *citing In re Baker Hughes Sec. Litig.*, 136 F. Supp. 2d at 646-47 ("[I]t is axiomatic that the Complaint cannot be amended by the briefs in opposition to a motion to dismiss.")

Even if the testimony could be used by Plaintiffs, it would still not allege a fraud claim. Plaintiffs do not contend that Chewco documents were fraudulently withheld from Enron's accountants. Moreover, as they do throughout the Consolidated Complaint, the Plaintiffs do not attribute fraud or knowledge of fraud to any particular Officer Defendant. Plaintiffs cannot state a claim against any Officer Defendant based on an accounting error without specifically stating facts regarding what each Officer Defendant knew, when he knew it, why he knew it, how he knew it and his knowledge *at the time* that the accounting treatment was fraudulent. The remainder of Plaintiffs' allegations regarding the restatement only rehash arguments that are treated in the Joint Disclosure Brief.

VI. THE CONSOLIDATED COMPLAINT FAILS TO ALLEGE FRAUD RELATED TO ENRON'S BUSINESS UNITS.

A. Plaintiffs' Consolidated Complaint Fails to Plead With Sufficient Particularity that Enron Committed Fraud in Connection With Enron's Wholesale Energy Trading Business.

The Joint Disclosure Brief showed that Plaintiffs' fraud allegations regarding WEOS were not pled with sufficient particularity to survive a motion to dismiss. Plaintiffs' Objection merely recycles the insufficient allegations from the Consolidated Complaint. Initially, Plaintiffs re-claim that Enron made misrepresentations related to its WEOS earnings by stating that WEOS was profitable and had strong prospects for growth. The Joint Disclosure Brief showed that such statements could not form the basis of a fraud claim because (1) they were true, and (2) even if Plaintiffs' allegations that the Officer Defendants manipulated assumptions to calculate its WEOS earnings were true,[18] Plaintiffs fail to state with sufficient particularity who made such assumptions and that such persons knew the particular statements were materially false or misleading at the time they were made. 15 U.S.C. § 78u-4(b)(2) ("[A] complaint shall, with respect to each act or omission alleged to have violated this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.")

Next, Plaintiffs repeat their claim that positive statements about WEOS made by Enron in a July 24, 2000 analysts' conference call were false and misleading because WEOS's business results had been manipulated and falsified to boost profitability by (1) phony hedging transactions with entities not independent of Enron, (2) the abuse of mark-to-market accounting, and (3) engaging in

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[18] Plaintiffs provide many imaginative examples of how Enron allegedly manipulated assumptions to inflate its WEOS earnings, including the manipulation of foreign-exchange rates, revenue growth, inflation rates, cost escalation, and economic growth and demand, claiming this provides the "missing" factual support Officer Defendants seek. *See* Objection at 44-45.

a practice Plaintiffs call "moving the curve." These allegations fail to satisfy the most basic pleading requirements of the PSLRA; Plaintiffs' Consolidated Complaint does not identify any specific statements regarding hedges, contract valuations and economic assumptions related to mark-to-market accounting or moving the curve that were allegedly false or misleading. Plaintiffs also do not allege where such statements were made, who made them or when. Plaintiffs do not even give specific examples of *when* each of the "manipulative" activities were engaged in or *how* WEOS's earnings were affected by such manipulations.

Plaintiffs next selectively attack the Officer Defendants' assertions that certain forward-looking statements were accompanied by meaningful cautionary language and are therefore not actionable.[19] Plaintiffs state that, contrary to Officer Defendants' representations, the October 13, 1999 and January 18, 2000 analysts' conference calls had no safe-harbor disclosures. This sweeping, bold-faced pronouncement is unsupported; Plaintiffs failed to provide a transcript or any other evidence that no such disclosures were made. Further, even if there was no cautionary language on these calls, the PSLRA also requires Plaintiffs to prove that the forward-looking statement was made or approved by an executive officer "with actual knowledge by that officer that the statement was false or misleading." 15 U.S.C. § 77z-2(c)(1)(B)(ii), 78u-5(c)(1)(B)(ii); *see, e.g.*, *Harris*, 182 F.3d at 803 ("Even if the forward-looking statement has no accompanying cautionary language, the plaintiff must prove that the defendant made the statement with 'actual knowledge' that it was 'false or misleading.'"); *In re Vantive Corp.*, 110 F. Supp. 2d at 1209 (same). Plaintiffs' Consolidated Complaint failed to identify with sufficient particularity who made these statements during the

[19] Defendants listed 13 allegations that were not actionable because they are protected by the safe-harbor language, the bespeaks-caution doctrine or simply immaterial puffing; Plaintiffs' Objection addresses only a few of them.

conference calls, which statements were false and misleading and that the speaker knew such statements were false and misleading. Finally, statements such as "Enron was very pleased" with the WEOS and the "[w]holesale business was very, very strong" are also protected as immaterial puffery. *See Calliott v. HFS, Inc.*, No. Civ. 3:97-CV-0924-I, 2000 WL 351753, at *6 (N.D. Tex. Mar. 31, 2000)(considering statements that management was "encouraged" or "pleased" with business conditions).

Plaintiffs also disparage the Officer Defendants' assertion that three quotes from Enron's "00 Annual Report" were protected by risk disclosure information, claiming that the cited cautionary language was actually found in Enron's Form 10-K; therefore, the Officer Defendants' claim is "wrong" because the Annual Report and the Form 10-K are *different documents*. *See* Objection at 46 (emphasis in original). What Plaintiffs apparently failed to notice is that the same meaningful cautionary language cited by the Officer Defendants, which is specifically aimed at Enron's WEOS business, is found in Enron's Annual Report *and* its Form 10-K and Form 10-Q.[20]

The Joint Disclosure Brief showed that none of Plaintiffs' 91 allegations related to WEOS was sufficient to state a claim. Plaintiffs' attempts to resuscitate fewer than ten of those allegations in Plaintiffs' Objection fail.

B. Plaintiffs Have Alleged No Particular Fraud In EBS.

The Officer Defendants' Joint Disclosure Brief explained that Enron Broadband Services ("EBS") was essentially a start-up company within Enron that was born from a small telecommunications company Enron acquired as part of Portland General. *See generally* Joint

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[20] *See* Joint Disclosure Brief's Master SEC Appendix at SEC App. Tab 16 at 24; SEC App. Tabs 6 at 53; SEC App. Tab 10 at 47; SEC App. Tab 14 at 21.

Disclosure Brief at 123-127. Officer Defendants admit that both of EBS's business centers foundered. *Id.* at 123-26. EBS's content delivery business failed after Blockbuster failed to provide content for EBS to deliver. *Id.* at 123-26. EBS's broadband intermediation (trading) business failed when the general decline in the broadband industry destroyed the credit of the parties with whom EBS had hoped to trade. *Id.* at 124-25. EBS was fraught with risks (which Enron disclosed) and it consistently lost money (which Enron also disclosed) during its less than two-year existence. *Id.* at 122-23, 134-36.

1. Allegations In Plaintiffs' Consolidated Complaint About EBS Cannot Survive PSLRA Analysis.

Plaintiffs' Consolidated Complaint relies primarily upon fraud by hindsight and forward-looking puffery by Enron executives who once had high hopes for EBS's future. *Id.* at 127-30. While Plaintiffs cite to a few fragments of statements that they claim were made by Enron executives, they fail to allege that the statements were false and/or fail to provide the particulars (who made the statement, who heard it, why it was false, etc.) that are required by the PSLRA and which would allow the Officer Defendants to actually identify the statements at issue. *Id.* at 130-32, 137-55. As demonstrated in the Joint Disclosure Brief, in those few instances where Plaintiffs have provided particulars, Officer Defendants have been able to show that the statements were never made. *Id.* at 140-55.

2. Plaintiffs' Objection Does Not Rehabilitate Their Consolidated Complaint's Defective Allegations.

The arguments in Plaintiffs' Objection does little to rehabilitate the deficient allegations in Plaintiffs' Consolidated Complaint. In most cases Plaintiffs simply regurgitate the allegations and repeat, with liberal use of italics and bold type, their general conclusory contention that everything about Enron was "***a sham***." But Plaintiffs still fail to allege why or how it was "***a sham***." Plaintiffs do not explain why they have failed to provide particularity, why the puffery they rely upon is actionable, or why they should be permitted to rely on fraud by hindsight to attack forward-looking statements. While those things Plaintiffs do contest in their Objection/Motion are addressed below, it is worth noting first a few of the many things that Plaintiffs do not contest.

a. Plaintiffs Were Warned About EBS's Risks.

Plaintiffs do not dispute that Enron repeatedly disclosed the risks associated with EBS. Enron warned:

> INFORMATION REGARDING FORWARD LOOKING STATEMENTS
>
> This Annual Report includes forward-looking statements . . . . Although Enron believes that its expectations reflected in these forward-looking statements are based on reasonable assumptions, such statements involve risks and uncertainties and *no assurance can be given that actual results will be consistent with these forward-looking statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements herein include . . . the ability to penetrate the broadband services market . . . ."*

And Enron further warned:

> Development of bandwidth as a commodity will be dependent, among other things, on the ability of the industry to develop and measure quality of service benchmarks and connectivity of networks of market participants to facilitate processing of contracted services. *There can be no assurance that such a market will develop.*

SEC App. Tab 10 at 56. And, of course, Enron repeated such warnings over and over again. Joint Disclosure Brief at 134-36.

b. Plaintiffs Were Told Of EBS's Mounting Losses.

Plaintiffs also do not dispute that Enron disclosed EBS's mounting losses:

$8 million for the first half of 2000;

$20 million in the third quarter of 2000;

$28 million for the first nine months of 2000;

$60 million for the year 2000;

$35 million in the first quarter of 2001;

$102 million for the first half of 2001.

Joint Disclosure Brief at 122-23.

c. Plaintiffs Do Not Contest That the Broadband Intermediation Market Evaporated.

Plaintiffs also do not dispute that EBS was just one of many broadband businesses that hit hard times in 2001. Plaintiffs do not even dispute that EBS's intermediation business failed because most of the counterparties with whom EBS was to trade in the new market it was trying to develop became uncreditworthy. Joint Disclosure Brief at 124-25.

d. Plaintiffs Do Not Contest That Blockbuster Could Not Provide The Content Needed For The Content Delivery Business.

Plaintiffs do claim that EBS's attempt to develop a video on demand business failed because of technical problems, but Plaintiffs fail to identify those technical problems[21] and Plaintiffs do not contest that even absent those alleged technical problems, VOD would have failed in any event because Blockbuster (which was supposed to supply the movies) could not obtain licenses for the

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[21] Plaintiffs *repeat* their allegation from the Consolidated Complaint that VOD was unsuccessful and a sham but still fail to show that they plead with sufficient particularity how it was unsuccessful. (Response at 43.) Plaintiffs refer to the necessity of set-top boxes in implementing the system, but they cannot dispute that thousands, if not millions of cable viewers have such boxes and they never allege that the customers in the VOD test market did not get VOD. Plaintiffs also repeat their allegation that "EBS executive Rice went so far as to tell two engineers that they were essential because Enron could not 'deliver the Blockbuster deal,'" NCC at ¶ 300(o), but Plaintiffs provide no further context for the statement or identify the two unnamed engineers Mr. Rice was allegedly trying to recruit with this statement. Indeed, Plaintiffs do not even explain whether these two engineers who were, according to Plaintiffs' claim, essential to EBS delivering the Blockbuster deal, agreed to come back to work for Enron after Mr. Rice talked to them.

movies that Plaintiffs claim Enron's technology was supposed to deliver. NCC ¶ 301 (VOD "... was unable to go forward because Blockbuster had not obtained and could not obtain the legal right to deliver movies from movie studios in digital format, the only format which could be utilized for VOD.")[22]

e. EBS Was Launched In January 2000.

Plaintiffs accuse the Officer Defendants of misrepresenting that EBS was launched in January 2000. Objection at 40. Plaintiffs argue that the transcript of the analyst conference in January 2000 says only that "'Enron Communications' is being 'renamed' EBS, not that EBS was being 'launched.'" Objection at 40. Plaintiffs continue their accusation, "For several pages, defendants base or buttress their arguments on the assumption that EBS was not launched until 00. They are simply wrong." Objection at 40. Actually, it is Plaintiffs that are simply wrong.

EBS was launched in January 2000. It had previously been a small communications business that Enron had acquired as part of the purchase of Portland General and to which Enron initially assigned a value of zero. It was only in January, 2000 that Enron unveiled its plans to rename the company EBS and make it a core business at Enron. Contrary to Plaintiffs' accusation, the Officer Defendants did not attempt to conceal the prior (and very modest) existence of the business. At the start of the Broadband section of the Joint Disclosure Brief, Officer Defendants explain that EBS was "born from a small telecommunications company that Enron acquired as part of Portland General. In January 2000, Enron *renamed* the company Enron Broadband Services, '*unveiled* its communications business,' and announced that this business would now be a core business at

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[22] The Consolidated Complaint also acknowledges that EBS tried but failed to secure content directly from the studios. NCC ¶ 300(o).

Enron." Joint Disclosure Brief at 120 (quoting NCC¶ 204) (emphasis added). Moreover, contrary to Plaintiffs' claim that the Officer Defendants attempted to conceal the prior existence of a communications business when they referred to EBS being launched in January, 2000, the Officer Defendants actually wrote in the very next sentence after the one Plaintiffs quote, "Prior to that time EBS was not a core Enron business, but rather a company that Enron had received as part of the purchase of Portland General and to which Enron had assigned a value of 'a full zero.'" Joint Disclosure Brief at 141.

f. Everyone Knew Broadband Was New.

Plaintiffs dispute Officer Defendants' contention that the "'market recognized that Enron was entering uncharted cyberspace in these ventures.'" Objection at 44. Plaintiffs then cite some puffing statements by the Officer Defendants such as that Enron has "the killer [application] for the entertainment industry" and that Enron was going to "change the whole entertainment experience for the average American." *Id.* at 44. Plaintiffs' position is flawed in at least two respects. First, puffing statements are not actionable. Second, it defies logic for Plaintiffs to claim that the market did not know this was a new venture in light of the widely known fact that there was no such thing as broadband just a few years before. The novelty of Enron's endeavor was underlined by the very puffing comments Plaintiffs cite. Enron could not "change the whole entertainment experience for the average American" by doing something that was not new.

g. Enron Did Not Invest Nearly Three Quarters Of A Billion Dollars In A Business It Knew Would Fail.

Plaintiffs argue that Officer Defendants "offer ***no*** support" for their claim, that "Enron did not foresee that the Broadband market would melt down or that Blockbuster would be unable to fulfill its commitment to secure movies for video on demand." Objection at 44 (emphasis in original). The "support" for the statement that Enron did not foresee that the broadband market would melt down is the undisputed fact that Enron invested hundreds of millions of dollars in broadband. The "support" for the statement that Enron did not foresee that Blockbuster would be unable to fulfill its commitment to secure movies for video on demand, is that Enron spent millions developing and test marketing a system to deliver movies Blockbuster was supposed to provide. It is Plaintiffs who "offer ***no*** support" for their claim that Enron knew broadband could not succeed and yet still chose to throw nearly three quarters of a billion dollars into it.

h. Plaintiffs Still Have Not Explained How Any EBS Customer Was "Unreal."

Plaintiffs Consolidated Complaint alleged that "EBS did not have a single real customer in 1999." NCC ¶ 300(h). Officer Defendants pointed out that, "[t]his allegation ignores that EBS was not launched or called EBS until January, 2000. Further, Plaintiffs' Consolidated Complaint points to no statement by anyone at Enron claiming that EBS *had* a single customer in 1999, let alone explain why any claimed customer was 'unreal.'" Joint Disclosure Brief at 142. Plaintiffs now attempt to fill in the detail their Consolidated Complaint so sorely lacks by pointing out that in January, 2000, Mr. Rice said, "'If you look at some of our customers . . . Lucent, Sun, IstreamTV, . . . CountyCool.com . . . Latin Soccer, NextVenue, Adams Films. . . .'" Objection at 47. Of course, in January, 2000 EBS was launched and, therefore, could then be said to have customers. Moreover, while Plaintiffs have now identified some claimed customers, they have still failed to "explain why any claimed customer was 'unreal.'"

i. Plaintiffs Allege No Facts In Support Of Their Claim That EBS Abused (Or Even Used) Mark-To-Market Accounting For Project Braveheart.

Plaintiffs complain, "An additional factual argument – again without support – was 'Enron did not use mark-to-market accounting on Braveheart at all.'" Objection at 47. But Plaintiffs ignore that their allegation that such accounting *was* used on Braveheart is without any supporting facts, details, or support of any kind. Plaintiffs can cite to no person or document for that proposition because it is not true. If Plaintiffs would plead with particularity what facts purportedly support their conclusion that mark-to-market accounting was used on Braveheart, the Officer Defendants could demonstrate why Plaintiffs are mistaken. Plaintiffs should not be heard to complain about a lack of specificity in responding to their allegations, when it is precipitated by the lack of specificity in the allegations themselves.[23]

j. The Sentence Fragments Plaintiffs Attribute To Mr. Skilling Are Not Inconsistent.

Plaintiffs acknowledge that Enron's President, Jeffrey Skilling, told the world in July, 2001 that "there was 'a meltdown out there' in the broadband area." Objection at 45. Plaintiffs claim that this was insufficient disclosure because "***four months earlier***" he had told some EBS executives in Portland that "the broadband business faced 'a complete meltdown,' and that same month, 3/01, Skilling told investors in New Orleans that Enron's broadband operation was going full speed 'pedal to the metal.'" Objection at 45 (emphasis in original). The first problem with Plaintiffs' allegation

[23] Plaintiffs also fail to plead how any of the accounting for EBS (whether mark-to-market or otherwise) was inappropriate. They claim that EBS should not have realized profits on Braveheart for VOD, because it knew VOD would fail, but as noted above, Plaintiffs fail to allege any facts to support the implausible notion that Enron knew from the start that VOD would fail. In addition, when it did fail, Enron took appropriate charges. Joint Disclosure Brief at 126.

is that they attribute only sentence fragments to Mr. Skilling without gracing the Court or the parties with even so much context as the rest of the sentence. But even the fragment Plaintiffs quote shows no fraud because "*facing*" a complete meltdown (as Skilling allegedly said in March 2001) is what one does before one *has* a complete meltdown (as Skilling said in July 2001). Even from Plaintiffs' context-deprived sentence fragments it appears that in March, Skilling was warning of a possibility that might or might not come to pass, and in July 2001, he was admitting that the meltdown had in fact occurred. Plaintiffs' suggestion that Skilling's similarly context-deprived "pedal to the metal" comment in March 2001, was designed to hide the possibility of difficulty in the broadband market is also belied by another allegation in Plaintiffs' own Consolidated Complaint. Plaintiffs themselves quote Skilling as telling the media in October, 2000 that "a broadband glut" was "a very real possibility." NCC ¶ 264. As explained in the Joint Disclosure Brief, Enron and many others saw the glut coming and Enron hoped to take advantage of it, but when the glut deepened beyond anyone's expectations in the first half of 2001 and broadband companies became uncreditworthy, Enron found itself without any creditworthy counterparties with whom to trade. Joint Disclosure Brief at 124-25.

k. EBS's Statements Were True; Plaintiffs' Allegations About Them Are Not.

The need for particularity is underlined again by Plaintiffs' allegations relating to a January 2000 PowerPoint presentation. Plaintiffs made a few particular allegations and they were demonstrably false. Plaintiffs alleged:

> Indeed, the 1/00 analyst presentation about EBS was a study in how to lie with Power Point slides: "Current" lines on a U.S. map purportedly showed ***actual*** fiber-optic lines, but, in truth, EIN was ***all dark***, *i.e.*, non-functional, at the end of 99; "pending" indicated lines under construction, but most were not in substantive development; and where a map purported to show the ECI South America network under

> development, in fact, ***there was never anything under construction in South America***. These claims were untrue – the broadband group was already in "***crisis management mode***."

NCC 214(i) (emphasis in original). The Officer Defendants produced the slide that Plaintiffs quoted as referring to "current" lines and to other "pending" lines that "purportedly showed ***actual*** fiber-optic lines," when "in truth, EIN was ***all dark***"and that map said nothing about any lines being current or pending. The slide also did not say anything about whether any of the lines were lit or dark. In their Objection, Plaintiffs attempt to amend their allegation to instead refer to an oral statement by Mr. Skilling:

> [O]ur fiber network – is expanding. To be quite honest, we've just about got all we need right now. We are extending it to some places to get some additional capabilities, but we've got essentially the fiber backbone that we need to do what we need to do.

Objection at 46. But Plaintiffs do not allege that any part of the statement (that they now want to pretend is in their fraud complaint)[24] is false. Skilling explicitly refers to future expansion and he says nothing about how much of the fiber is lit or dark. Quite the contrary. In the two sentences immediately following the ones Plaintiffs quote, Mr. Skilling says:

> *Next phase* is going to be the development of the on ramps and the off ramps. These are server complexes that we're going to be distributing around the world that give us the ability to get on and off our backbone, but also to – to store and transfer enormous quantities of data, which is what is necessary for this broadband revolution that we were talking about.

App. Tab 49 at 4 (emphasis supplied). Mr. Skilling's reference to the need for on and off ramps indicates that the fiber is dark. There would be no reason to light the fiber on the backbone if there

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[24] "[I]t is axiomatic that the Complaint cannot be amended by the briefs in opposition to a motion to dismiss." *In re BMC*, 183 F. Supp. 2d at 915 *citing In re Baker Hughes Sec. Litig.*, 136 F. Supp. 2d at 646-47.

are no ramps to get on and off the backbone. Moreover, Plaintiffs allege elsewhere in their Consolidated Complaint that Enron somehow improperly booked profits from dark fiber sales in the third quarter of 2001. If, as Plaintiffs claim, Enron was telling the world that all of its fiber was lit in January 2000, it would have had a hard time telling the world in the third quarter of 2001 that it sold dark fiber.

Plaintiffs also alleged that Enron showed the analysts "a map purported to show the ECI South America network under development, in fact, ***there was never anything under construction in South America***." NCC ¶214(i) (emphasis in original).[25] In their Joint Disclosure Brief, the Officer Defendants showed that not only did they not make that statement or provide such a map, they made statements at that very meeting that made it clear they were not yet in South America. Joint Disclosure Brief at 144-45.

l. Plaintiffs Have Failed To Allege Facts Showing That EBS's Transactions Were Fraudulent.

Plaintiffs claim that Enron received a $100,000 order from RealNetworks and gave RealNetworks a purchase order for $7 million. The Officer Defendants responded that even if that is true, it does not allege any improper business practice, and the Officer Defendants noted that Plaintiffs have failed to allege any facts showing that either contract was invalid or inappropriate in any way. The same deficiency is apparent in Plaintiffs' allegations that Enron "booked a dark fiber deal with LJM worth over $300 million" where Plaintiffs fail to allege the terms of the deal or what revenue was (or should have been) reported on it. Joint Disclosure Brief at 145. Plaintiffs argue that

[25] Even if Enron had said that a South America network was "under development," when no such network was "under construction," the statement could still be true because "development" encompasses planning that precedes "construction."

this is "an issue for the jury, not a motion to dismiss," Objection at 46,[26] but this is a securities case and the PSLRA applies. Under the PSLRA a plaintiff cannot simply point to a transaction and say it was "***a sham***" or a "concealed" swap, without alleging facts supporting that conclusion. If the Plaintiffs cannot allege particular facts, they do not get to put any issues before a jury.

C. The Plaintiffs Have Failed to Plead Fraud Regarding Enron Energy Services.

Plaintiffs do not seriously challenge their failure to plead a fraud claim based on Enron Energy Services' ("EES") business, devoting only two paragraphs of their Objection to EES. The few matters addressed by Plaintiffs are addressed in the Section I.B.2.c. of Defendant Lou L. Pai's Reply in Support of Motion to Dismiss Consolidated Amended Complaint. Those arguments are adopted here and incorporated herein by reference.[27]

D. Plaintiffs' Allegations Regarding Enron International Also Fail.

Plaintiffs' allegations of fraud at Enron International are as unavailing as its claims against other Enron business units. Plaintiffs quote a *Newsweek* article that says Enron lost $1 billion on the Indian project by the late 1990s. Objection at 27. Still later, they argue that Dabhol's valuation (which they never plead) was grossly inflated and political issues made recovery of initial funding doubtful. Objection at 48-49. Plaintiffs ignore the extensive public disclosures in which Enron

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[26] Plaintiffs also claim that the Officer Defendants simply contradict their allegations that EIN was dependent on the success of InterAgent, but in fact, the Officer Defendants cite to a report that the court can consider on a motion to dismiss, because the same report is relied upon by plaintiffs (NCC ¶ 211.) Plaintiffs ignore that their own allegation that EIN was dependent on InterAgent is entirely conclusory and Plaintiffs cite to no person, document or source of any kind for the allegation. Objection at 46.

[27] Any loss associated with any allegedly undisclosed EES risk would be immaterial as a matter of law. EES was, for 1999, 3.78% of Enron's revenue and (3.41)% of its IBIT and for 2000, 3.79% of Enron's revenue and 6.65% of IBIT. EES operated at a significant loss before 1999. *See Abrams,* 2002 WL 1018944 at 10 (J. Parker, concurring) (accounting irregularities in Baker Hughes subsidiary that accounting for only 20% of overall company income was immaterial.)

disclosed the financial setbacks with the Dabhol project. For example, at pp. 192-99 of the Joint Disclosure Brief, the Officer Defendants already quote (and Plaintiffs completely ignore in their Objection) the SEC filings in which Enron: disclosed even before the Class Period the 1.5-year complete shutdown in operations for Dabhol, disclosed each of the subsequent delays on the Dabhol project as they occurred, disclosed the Marharashtra State's subsequent refusal to perform under the contract and the asset seizures (again disclosing each of these events as they occurred), and stating that there was no assurance that Enron would prevail, or that it would ever collect on its investment even if it did ultimately prevail. Plaintiffs do not refer to these detailed disclosures in their Objection, nor the forward-looking statements (discussed in the same section of the Joint Disclosure Brief) where Enron specifically warned of the inherent risk associated with projects in emerging nations.

The remainder of Plaintiffs' Objection deals with claims that Enron falsified its financial condition through "snowballing." Objection at 49-51. The Joint Disclosure Brief, however, discusses Plaintiffs' failure to plead a claim relating to snowballing in compliance with the PSLRA, as well as extensive disclosures for same. *See* Joint Disclosure Brief at 206-14. Plaintiffs do not so much as refer to that section, let alone respond to it.

VII. THE MARKET WAS AWARE OF THE DEBT PLAINTIFFS CLAIM WAS HIDDEN.

Plaintiffs' Motion/Objection ends similar to how it began: using querulous arguments that obscure rather than address the Joint Disclosure Brief arguments. Defendants ask the Court to ignore the context and content of various analysts' and press reports that the Plaintiffs quote out-of-context throughout the Consolidated Complaint. The full content of these reports demonstrates, not only Plaintiffs' out-of-context use, but how the analysts understood Enron's disclosures and the heightened risks of investing in Enron and how the press and analysts issued that information to the markets. "Because of its business, including that of price risk management services, Enron could be exposed to more market risk than the average energy company."[28] "With its use of financial instruments, ENE could be exposed to market and credit risks resulting from adverse changes in commodity and equity prices."[29] "[Enron Capital & Trade] has significant flexibility in . . . booking earnings. It is primarily a financial business . . . [that can] recognize the economic value of projects long before they are operational and cash is coming in . . . . This limits the comparability of financial statements, as a project's bottom-line effect is bound only by ECT's financial engineering skills."[30] Other analysts' reports emphasized the extensive use of Enron's off-balance sheet financing, derivatives, securitizations and monetizations, among other things.[31]

Excerpts from media reports relied on by Plaintiffs in the Consolidated Complaint further show that the "hidden" facts about Enron were disclosed to the market. These press reports told of Enron's extensive use of off-balance sheet and other "ground breaking" and "innovative" financing.[32] The press further reported on the losses and difficulties at Enron's business units during the Class Period.[33] Since Plaintiffs claim to have relied on these reports, it is only proper that the Court consider their entire contents in support of Defendants' motions to dismiss. F.R.C.P. 56; *Bovee v.*

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[28] Joint Disclosure Brief at 234, *citing* App. Tab 16 at 1.

[29] Joint Disclosure Brief at 235, *citing* App. Tab 30 at 2.

[30] Joint Disclosure Brief at 236, *citing* App. Tab 21 at 4, 6, 20-21.

[31] Joint Disclosure Brief at 237-38, *citing* App. Tab. 21 at 37, App. Tab 30 at 2; App. Tab 34 at 2; App. Tab 35 at 1; App. Tab 36 at 1; App. Tab 37 at 1, 3; App. Tab 46 at 216 at 1.

[32] Joint Disclosure Brief at 239-242, *citing* App. App. Tab 2 at 1-4; App. Tab 4; App. Tab 7; App. Tab 8 at 4; App. Tab 9 at 1.

[33] Joint Disclosure Brief at 234, *citing* App. Tab 1 at 1-2; App. Tab 3 at 1; App. Tab 5; App. Tab 6.

Coopers & Lybrand C.P.A., 272 F.3d 356 (6th Cir. 2001); *In re BMC*; 183 F. Supp. 2d at 881-84.

Conclusion

Dispassionately considered, Plaintiffs' arguments raise no reason to strike the Officer Defendants' Joint Disclosure Brief, which provides the Court with essential context in which to consider Plaintiffs' false and extravagant claims of non-disclosure. The Motion to Strike and Objections should accordingly be denied. As for the Objection portion of the Motion, it merely reargues Plaintiffs' position on the defendants' Motions to Dismiss. The Joint Disclosure Brief undermines significant portions of Plaintiffs' claims and underscores the case for granting defendants' Motions to Dismiss or requiring the Plaintiffs to replead.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing document was served on all counsel by posting it on the website previously agreed to by the Plaintiffs and the Officer Defendants on this 24th day of June, 2002.

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